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CHIEF CLERK'S OFFICE

ILLINOIS-AMERICAN WATER COMPANY)
)
Proposed general increase in water and)
wastewater rates)

02-0690

**BRIEF OF THE VILLAGE OF BOLINGBROOK
ON EXCEPTIONS TO THE PROPOSED ORDER**

NOW COMES the Village of Bolingbrook ("Bolingbrook"), by its attorneys, Moss and Bloomberg, Ltd., and pursuant to 83 Ill. Admin. Code, Title 83 §200.830, as its exceptions to the Proposed Order states as follows:

I.

Section IV.D. of the Proposed Order Misapplies the "Four Corners" Rule

Section IV.D. of the Proposed Order incorrectly characterizes Bolingbrook's position with respect to Section 5.3. of the Asset Exchange Agreement. Substitute language is proposed with respect to this Section in Bolingbrook Exception 1.0. attached.

A.

There is no dispute that the plain language of Section 5.3's formula only refers to Citizens Utilities Company of Illinois ("CUCI"). *See*, Proposed Order at pp. 9-10, Bolingbrook Exhibit 1.1. at pp. 21-22. There is no dispute that the plain language of Section 5.3. does not refer to Illinois-American Water Company ("IAWC") or any of its operating districts, including the Chicago Metro

Water District. *See*, Proposed Order at p. 11, Bolingbrook Exhibit 1.1. at pp. 21-22. There is no dispute that the Asset Exchange Agreement was assigned by Citizens to IAWC. *See*, Proposed Order at p. 9.

However, the Proposed Order assumes that, by virtue of the assignment from Citizens to IAWC, the formula in Section 5.3. was amended *de facto*. There is an unjustified leap of logic implicit in this assumption. The legal and logical nonsequitur is that the “four corners” rule allows terms in a contract to be rewritten by virtue of an assignment. As a matter of law, however, the four corners rule never allows terms in a contract to be rewritten (by assignment or otherwise). The four corners rule, as the name implies, strictly limits interpretation of the contract to the words that are actually used in the contract itself. Under the rule, the parties’ intent must be ascertained solely from the language that appears on the face of the agreement. *Air Safety, Inc. v. Teachers Realty Corporation*, 185 Ill.2d 457, 706 N.E.2d 882, 884, 236 Ill.Dec. 8 (1999) (explaining the nature of the four corners rule); *Omnitrus Merging Corporation v. Illinois Tool Works, Inc.*, 256 Ill.App.3d 31, 34, 195 Ill.Dec. 701, 628 N.E.2d 1165 (1993). If the language in the contract is clear and unambiguous, the judge must determine the intention of the parties “ ‘solely from the plain language of the contract’ and may not consider extrinsic evidence outside the ‘four corners’ of the document itself.” *Omnitrus*, 256 Ill.App.3d at 34, 195 Ill.Dec. 701, 628 N.E.2d 1165. *See Meyer v. Marilyn Miglin, Inc.*, 273 Ill.App.3d 882, 888, 210 Ill.Dec. 257, 652 N.E.2d 1233 (1995) (stating “[i]f the contract terms are unambiguous, the parties’ intent must be ascertained exclusively from the express

language of the contract, as a matter of law”). Here, the express language of Section 5.3. on its face only refers to Citizens. *See*, Proposed Order at pp. 9-10; Bolingbrook Exhibit 1.1. at pp. 21-22. What has occurred is that IAWC has introduced “parol evidence” of the assignment of the Asset Exchange Agreement from Citizens to IAWC. Based on the parol evidence of the assignment, the Proposed Order concludes that Section 5.3’s formula should be modified from its express language.

If the Proposed Order finds that the Asset Exchange Agreement is unambiguous, then, under the four corners rule, the assignment cannot be considered as a matter of law because it is parol evidence. On the other hand, if the Commission determines that Section 5.3’s formula has been rendered ambiguous by virtue of parol evidence regarding the assignment, then the Commission must likewise consider Bolingbrook’s parol evidence under *Martindell v. Lake Shore National Bank*, 15 Ill.2d 222, 154 N.E.2d 683, 689 (1958). *See*, Bolingbrook’s Initial Brief at PP. 8-11; Bolingbrook’s Reply Brief at pp. 3-5.

In short, the legal analysis in Section IV.D. is incorrect. Legally, for the Commission to consider parol evidence of the assignment from Citizens to IAWC, it must first find that Section 5.3 is ambiguous. Only after that finding is made can the Commission evaluate the effect of the assignment and other parol evidence, including the evidence introduced by Bolingbrook’s Exhibit R-1.1, under the “four corners” rule. Bolingbrook’s evidence goes directly to demonstrating the intent of CUCI and Bolingbrook, as the parties to the Asset Exchange Agreement. As Mr. Drey testified, Bolingbrook Exhibit R-1.1. shows that the intent of Bolingbrook and CUCI was that the

formula in the first paragraph of Section 5.3. would utilize CUCI's "current" water rate base, not a future water rate base. Based on all the evidence, including the parol evidence submitted by IAWC and Bolingbrook, it is clear that Bolingbrook's position should be sustained in the Proposed Order because its evidence reflects the intent of the parties to the Asset Exchange Agreement, i.e. CUCI and Bolingbrook.

B.

The second to last paragraph of Section IV.D. states:

As the Company has also observed, Bolingbrook's recommendation does not take into consideration the effect of rate base additions to be included pursuant to the final paragraph of Section 5.3.

This language states that Bolingbrook's recommendation would have the effect of excluding rate base additions from IAWC's rate base. That statement is not accurate.

Bolingbrook's testimony only relates to the valuation of Bolingbrook water utility assets under the Section 5.3. formula as contained in the first paragraph of the Section. Bolingbrook's objection to IAWC's calculation is not that IAWC has included utility plant, constructed after the execution of the Asset Exchange Agreement, in IAWC's rate base. Post-agreement utility plant is governed by the final paragraph of Section 5.3.

What Bolingbrook objects to is including utility plant constructed after the execution of the Asset Exchange Agreement in the Formula for valuing the Bolingbrook water utility assets, which effectively counts the post-Agreement IAWC utility plant twice. Under IAWC's approach, post-agreement IAWC plant is included once in rate base (i.e., under the final paragraph) and, then, a second time in the Bolingbrook asset value (i.e., under the first paragraph).

Thus, it is incorrect to say that Bolingbrook's recommendation does not "take into consideration the effect of rate base additions to be included pursuant to the *final paragraph* of Section 5.3." (Emphasis supplied). Bolingbrook has never objected to rate base additions, as required by the final paragraph at Section 5.3., being included in IAWC's rate base. *See*, Bolingbrook Initial Brief at pp. 5-11; Bolingbrook Reply Brief at pp. 1-5. However, Bolingbrook's recommendation does exclude 100% of post-Agreement IAWC Plant from being included in the computation of the Bolingbrook asset value under the first paragraph. This is a significant variance from the language of the Proposed Order.

For these reasons, Bolingbrook respectfully submits that Section IV.D. of the Proposed Order should be amended in accordance with Bolingbrook Exception 1.0 attached.

II.

The Commission Order in Docket No. 01-0556 Requires Illinois-American Water Company To Prove All Acquisition-Related Savings

The Commission, in Docket No. 01-0556, approved a methodology, which IAWC was permitted to use in order to meet its burden of proving that there were, in fact, Acquisition Savings attributable to IAWC's acquisition of CUCI's assets. *See*, Order in Docket No. 01-0556. While it is true that applying the methodology establishes a *prima facie* case with respect to the existence of Acquisition Savings, the Proposed Order fails to take into account other evidence in the record cited by Bolingbrook, that rebuts the *prima facie* case. *See*, Proposed Order at pp. 26-29. Whether Bolingbrook introduced the other evidence in its own testimony is irrelevant. The fact is that this evidence appears in the record and cannot be ignored.

Bolingbrook agrees that the Staff's calculation of Acquisition Savings is mechanically correct according to the methodology. Bolingbrook disagrees however, that application of the methodology satisfies IAWC's burden of proof. While following the methodology does establish a *prima facie* case that Acquisition Savings may have been realized, the record in this case further provides evidence that serves to rebut the *prima facie* case.

In this proceeding, the burden of proof to establish the "justness and reasonableness" of the proposed Acquisition Savings is placed upon IAWC. See, 220 ILCS 5/9-201(c). The term "burden of proof" means that the petitioner has both burden of producing evidence, as well as the burden of persuading the trier of fact that certain facts are true. *Ambrose v. Thorton Township School Trustees*, 274 Ill.App.3d 676, 654 N.E.2d 545, 211 Ill.Dec. 83 (1995). The petitioner's "burden of production" is satisfied when the petitioner presents sufficient evidence on each element of cause of action, thereby establishing *prima facie* case; once the petitioner sets forth *prima facie* case, the burden of production shifts to the respondent to come forward with evidence to rebut the *prima facie* case. *Id.*, *Anderson v. Department of Public Property*, 140 Ill.App.3d 772, 489 N.E.2d 12, 95 Ill.Dec. 60 (1986). That is precisely what has occurred in this proceeding. The methodology establishes the *prima facie* case; the record supplies Bolingbrook's rebuttal evidence. As Bolingbrook has argued in its Initial Brief (at p. 11-16) and in its Reply Brief (at p. 5-6), the evidence in the record demonstrates that, with respect to labor and labor-related Acquisition Savings, no such savings have, in fact, occurred.

According to IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8, the following is a summary of the changes in labor costs since the CUCI closing:

Chicago Metro Division

	December 31, 2001 (Historical)		December 31, 2003 (Pro forma)
\$	1,556,358 (water)	\$	2,666,642 (water)
	<u>1,191,934 (sewer)</u>		<u>1,025,842 (sewer)</u>
\$	2,748,292	\$	3,692,484

See, IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8.

IAWC has failed to adequately explain on this record how an increase in labor expenses of \$944,000 (or 34%) since IAWC assumed control over the Chicago Metro Division from CUCI in January 2002 can somehow be categorized as labor expense “savings” of \$821,000.

CUCI had adequate personnel immediately prior to the closing to provide safe and reliable public utility service. As the Commission specifically found in Docket No. 00-0476 “There has been no showing that Citizens has been unable to provide safe and reliable service or to raise necessary capital.” Order in Docket No. 00-0476, Section E., p. 39. If CUCI’s personnel were able to provide safe and reliable service to the Chicago Metro Division on December 31, 2001, IAWC’s proposed increase in labor-related expenses by \$944,000 from historical year 2001 to pro forma 2003 flatly contradict IAWC’s claim of labor-related Acquisition Savings of \$821,000. In fact, it appears that instead of producing labor cost savings, IAWC’s acquisition of CUCI’s assets has actually caused labor and labor-related costs to jump by 34%, according to IAWC’s own testimony. Moreover, if the \$944,000 increase in labor-related expenses (IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8) is used to offset the reported savings in the categories of management fees, rate case expense and Citizens Rate Area long term debt (*see*, IAWC Exhibit 12.0 Schedule C-2.4 p. 1 of 1 at lines 2, 3 and

5), then the total amount of Acquisition Savings is actually a negative number.

In short, while the methodology may be sufficient to establish a *prima facie* case with respect to Acquisition Savings, there is other evidence in the record which rebuts the *prima facie* case. Based on the other evidence in the record, it is apparent that IAWC has failed to meet its burden of proving, by a preponderance of the evidence, that there were, in fact, labor and labor-related Acquisition Savings which resulted from IAWC's acquisition of CUCI's assets.

For these reasons, Bolingbrook respectfully submits that Section V.G. of the Proposed Order should be amended in accordance with Bolingbrook Exception 2.0. attached.

III.

THE STAFF'S POSITION REGARDING THE CHICAGO METRO SEWER DISTRICT RATES SHOULD BE ADOPTED

The Proposed Order would permit IAWC to charge rates to Chicago Metro Sewer District's customers that would be in excess of the Company's originally filed tariff rates. See, Proposed Order at p. 116. Bolingbrook agrees with the Staff position (Staff Reply Brief at 57, citing Docket 00-0513/00-514 (Consol.) at p.12) that the Commission cannot authorize rates that exceed the originally filed tariff rates. If there are computational errors made by the Company, which result in the originally filed tariff rates being lower than the Company's calculated revenue requirement, the Company must accept the consequences of its own miscalculation, not the ratepayer. Section 9-201(a) of the Public Utilities Act (220 ILCS 5/9-201(a)) provides as follows:

(a) Unless the Commission otherwise orders, and except as otherwise provided in this Section, no change shall be made by any public utility in any rate or other charge or classification, or in any rule, regulation, practice or contract relating to or affecting any rate or other charge, classification or service, or in any privilege or facility, except after 45 days' notice to the Commission and to the public as

herein provided. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules or supplements stating plainly the change or changes to be made in the schedule or schedules then in force, and the time when the change or changes will go into effect, and by publication in a newspaper of general circulation or such other notice to persons affected by such change as may be prescribed by rule of the Commission. The Commission, for good cause shown, may allow changes without requiring 45 days' notice herein provided for, by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

When any change is proposed in any rate or other charge, or classification, or in any rule, regulation, practice, or contract relating to or affecting any rate or other charge, classification or service, or in any privilege or facility, such proposed change shall be plainly indicated on the new schedule filed with the Commission, by some character to be designated by the Commission, immediately preceding or following the item.

When any public utility providing water or sewer service proposes any change in any rate or other charge, or classification, or in any rule, regulation, practice, or contract relating to or affecting any rate or other charge, classification or service, or in any privilege or facility, such utility shall, in addition to the other notice requirements of this Act, provide notice of such change to all customers potentially affected by including a notice and description of such change, and of Commission procedures for intervention, in the first bill sent to each such customer after the filing of the proposed change.

Given the mandatory nature of Section 9-201(a)'s notice provisions, it would be error for the Commission to permit IAWC to charge Chicago Metro Sewer District customers rates in excess of the originally filed tariff rates. Staff's position should, therefore, be affirmed by the Commission.

Bolingbrook Exception 3.0 to the Proposed Order sets forth the pertinent language amendments which would be made to the third paragraph on p. 116, Section VII.H.2 of the Proposed Order.

IV.

THE ATTORNEY GENERAL'S SINGLE TARIFF
PRICING PROPOSAL SHOULD BE ADOPTED

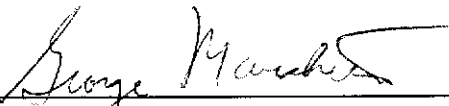
For the reasons previously set forth in Bolingbrook's Initial Brief at pp. 21-23, and in the briefs of the Attorney General, Bolingbrook respectfully submits that the findings in Section VII.H.2. of the Proposed Order should be amended to adopt the Attorney General's single tariff pricing proposal in its entirety.

Bolingbrook Exception 4.0 revises the language of Section VII.H.2., beginning with the last full paragraph on page 114 of the Proposed Order and ending with the last full paragraph on page 115.

CONCLUSION

For the foregoing reasons, the Village of Bolingbrook respectfully submits that the Proposed Order should be amended in accordance with Bolingbrook Exceptions 1.0, 2.0, 3.0 and 4.0.

Respectfully submitted,



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Bolingbrook Exception 1.0 To the Proposed Order (Proposed Language for Section IV.D.)

D. Village of Bolingbrook Rate Base Issue

Under an **Asset Purchase and Exchange Agreement**, the Village of Bolingbrook conveyed its water utility assets to Illinois-American in exchange for certain cash payments and the Company's wastewater treatment assets located in the Village of Bolingbrook ("Village" or "Bolingbrook"). The Agreement is dated October 8, 1996 and originally was between Citizens Utilities Company of Illinois ("Citizens" or "CUCI") and the Village. Illinois-American states that the Agreement was assigned to it when Illinois-American acquired the water and wastewater assets of Citizens in 2002. (IAWC brief at 41) IAWC'S statement, relative to the assignment of the Asset Purchase and Exchange Agreement, is parol evidence under the "four corners" rule, as discussed below. A copy of the Agreement was entered into the record as Bolingbrook Ex. 1.0.

In Docket No. 01-0001, the Commission entered an Order on April 10, 2002 granting IAWC a certificate of public convenience and necessity for the resulting additional water service area in the Village, determining the original cost less depreciation as of July 1, 2001 of the water assets to be acquired from the Village and approved accounting entries for the proposed transaction. The asset exchange took place on July 25, 2002. (IAWC brief at 41)

One of the provisions of the Agreement is Section 5.3, captioned "Rate Base Neutrality Covenant." A copy of Section 5.3 was presented as IAWC Ex. R-1.18. Section 5.3 provides as follows:

Section 5.3. Rate Base Neutrality Covenant.

Citizens and Bolingbrook recognize that, as a consequence of the exchange of the Bolingbrook water supply system for the Citizens sewage treatment plants, Citizens will petition the Illinois Commerce Commission to include the former Bolingbrook water supply system in its rate base for rate making purposes. Citizens and Bolingbrook agree that the exchange of their respective utility assets should be rate base neutral, i.e., after the exchange of assets, the average net rate base per water customer, living in Bolingbrook and served by Citizens, should neither increase nor decrease, except as provided in this Section 5.3. Citizens, therefore, agrees that it will only petition the Illinois Commerce Commission, in any rate case subsequent to Closing, to add the following maximum amount to its water rate base as a result of the asset exchange:

$$\begin{array}{c} \text{CUCI's Net Water Plant Rate Base} \\ \text{for all Illinois Customers} \\ \div \\ \text{The Total Number of CUCI's Illinois} \end{array}$$

Water Customers

x

The Total Number of Water Customers
Residing in the Bolingbrook Service Area

EQUALS:

Maximum Rate Base Increase as a Result
of the Asset Exchange

The Bolingbrook Service Area is shown on Exhibit D attached hereto and made a part hereof.

Thus, irrespective of the value of STP #2 or STP #1, the value of the Bolingbrook Water System, or the payments made pursuant to Section 5.1 hereof, Citizens and Bolingbrook agree that the Maximum Rate Base Increase as a result of the exchange shall not exceed the above-calculated amount.

Bolingbrook and Citizens further recognize and agree that the Lake Michigan water connection and storage facilities to be constructed by Citizens to serve Bolingbrook customers (at an estimated cost of \$6.5 million), the cost of those facilities referenced in Section 5.4, the cost of any backbone facilities constructed by Citizens in the future to serve Bolingbrook customers and Citizens customers, and any New Customer Connection Payments made pursuant to Section 5.2 would be includable in Citizens' water rate base to the extent permitted by the Illinois Commerce Commission.

Under its interpretation of Section 5.3, the Company made its calculation of the "maximum rate base increase as a result of the asset exchange" based upon 2002 data because the exchange occurred in 2002. To properly calculate rate base in this proceeding, the Company states, it then updated the calculation for the 2003 test year increases in plant additions and depreciation. (IAWC Ex. R-1.0 at 23) This calculation is shown in IAWC Exhibit 11, Schedule B-2.3.

Bolingbrook's witness Mr. Drey proposed that the calculation of "Net Water Plant Rate Base for all Illinois Customers", in determining "maximum rate base increase as a result of the asset exchange", be made using CUCI'S Rate Base as determined by the Commission Order in Docket No. 94-0481, entered September 13, 1995, to be \$28,236.543. (Bolingbrook brief at 5)

In explaining its proposal, **Bolingbrook** says that after the Asset Exchange Agreement was "approved" by CUCI and Bolingbrook, CUCI never initiated a subsequent rate making proceeding before the Commission in which CUCI's Net Water Rate Base for all Illinois Customers was revalued or adjusted. According to Bolingbrook, the term "rate base" is commonly understood as the original cost value of utility property on which a return is allowed by the Commission.

Bolingbrook says CUCI's Net Water Plant Rate Base for all Illinois Customers, both at the time that the Asset Exchange Agreement was executed and at the time that the closing occurred, was set at \$28,236,543, which was the figure on which the Commission had allowed CUCI a return. Using this amount, Bolingbrook calculates that maximum rate base increase associated with the Bolingbrook assets should be limited to \$6,462,132 pursuant to the Section 5.3 formula. (Bolingbrook reply brief at 5) This calculation is shown on Bolingbrook Exhibit 1.2.

In addition, Bolingbrook argues, the plain language of Section 5.3 only refers to "CUCI's" Net Water Plant Rate Base for all Illinois Customers, not to the rate base of any other entity, such as the Chicago Metro District of Illinois-American Water Company. (VOB brief at 6-7) Bolingbrook says using the rate base for the Chicago Metro District of Illinois-American Water Company, as proposed by IAWC, raises the value used in the numerator of the formula to \$76,403,411. (Bolingbrook brief at 7)

According to Bolingbrook, substituting the IAWC Chicago Metro District for "CUCI" constitutes a "unilateral amendment" to the Section 5.3 formula. Bolingbrook says it never agreed to such an amendment, which in Bolingbrook's view is contrary to the integration clause in Section 14.3 of the Agreement, which states, "This Agreement shall not be modified or amended in any way except in writing approved by the parties hereto." (VOB brief at 7-8; VOB reply brief at 2-4)

In response to this argument, IAWC asserts that when the asset exchange occurred, Citizens Utilities no longer existed as the operating utility, and Bolingbrook made the asset exchange with Illinois-American, the assignee of the Asset Exchange Agreement. Obviously, IAWC argues, no amendment to the agreement was needed, as Illinois-American became the assignee. (IAWC reply brief at 24)

Although they disagree as to the inputs in applying the Section 5.3 formula as discussed above, neither party believes any ambiguity exists in the Section 5.3 formula. (VOB brief at 8; IAWC brief at 43-44) Bolingbrook "submits that the Section 5.3 formula is unambiguous and must be enforced as written." (VOB brief at 8) IAWC "submits that it is very clear." (IAWC brief at 44)

According to Bolingbrook, in the event the Commission determines, in the context of IAWC's acquisition of CUCI's assets, that the term "CUCI's Net Water Plant Rate Base for All Illinois Customers" has been rendered ambiguous, or susceptible of more than one meaning, then parol evidence may be considered. (VOB brief at 9, citing *Martindell v. Lake Shore National Bank*, 15 Ill.2d 272, 154 N.E.2d 683, 689 (1958)) In the event the Commission makes such a determination, and for purposes of clarifying the intent of the parties, Bolingbrook offered a letter written by CUCI's attorney in 1996 explaining the respective positions of the parties with respect to Rate Base Neutrality. (VOB brief at 9-10; VOB Ex. R-1.0)

IAWC objects to the letter offered by Bolingbrook. IAWC argues that a contract is not ambiguous simply because the parties disagree on the meaning of its terms, and that in the absence of an ambiguity, the intention of the parties is to be ascertained by the contract language, not by the

construction placed on it by the parties. (IAWC brief at 43, citing *Glenview v. Northfield Woods Water and Utility Co.*, 216 Ill.App.3d 40 (1st Dist. 1991)) In IAWC's view, the contract provisions are clear. The Company also argues that even if the letter is considered, it supports IAWC's interpretation, not Bolingbrook's. (IAWC brief at 44)

~~Having reviewed the record, the Commission finds that IAWC's calculation of rate base is consistent with the terms of Section 5.3 of the Agreement. Both parties suggest, and the Commission agrees, that the formula in Section 5.3 is not ambiguous.~~

~~In the Commission's opinion, the use of such terms as "after the exchange of assets" and "in any rate case subsequent to closing," in the context in which they are used in Section 5.3, supports the Company's argument that the calculation should be based on 2002 data, not data from Docket 94-0481, because the asset exchange occurred in 2002.~~

~~As noted above, Bolingbrook's claim that CUCI's rate base must be used in calculating rate base under Section 5.3 is based, at least in part, on its argument that substituting the IAWC Chicago Metro District for "CUCI" constitutes a "unilateral amendment" to the Section 5.3 formula contrary to the integration clause of the Agreement. The Company asserts that it is the assignee of CUCI under the Agreement, and Bolingbrook does not appear to dispute that particular assertion. Such a challenge might be somewhat problematic, inasmuch as Bolingbrook actually closed on the exchange with IAWC.~~

~~As the Company has also observed, Bolingbrook's recommendation does not take into consideration the effect of rate base additions to be included pursuant to the final paragraph of Section 5.3.~~

~~In conclusion, the Commission finds that the calculation of rate base by IAWC is consistent with the terms of Section 5.3 of the Agreement, and it should be accepted.~~

Having reviewed the record, the Commission finds that the term "CUCI's Net Water Plant Rate Base for All Illinois Customers" in Section 5.3's Formula is unambiguous. Since the language is unambiguous, under the "four corners rule", the Commission may only consider that express language used by the parties in interpreting Section 5.3. The express language only refers to CUCI, not IAWC or any other entity. Therefore, the Commission finds that Bolingbrook's calculation of the rate base increment, attributable to the Bolingbrook water utility assets, to be correct.

Even if the Commission were to determine that the assignment of the Asset Exchange Agreement by CUCI to IAWC had created an ambiguity and that parol evidence should therefore be considered, the Commission's conclusion on this issue would remain the same. The assignment, being outside of the four corners of the Asset Exchange Agreement, is parol evidence only. Bolingbrook likewise submitted parol evidence, consisting of a letter from CUCI's attorney, Timothy Callahan, which letter is identified as Bolingbrook Exhibit R-1.1. That letter identifies the significant issues which were being negotiated by Bolingbrook and CUCI with respect to the Asset

Exchange Agreement.

Mr. Callahan's letter identifies "Water Rate Base Neutrality" as one of the significant issues. Mr. Callahan explains the respective positions of the parties as follows:

5. Water Rate Base Neutrality
- Bolingbrook wishes to cap any increase in CUCI's water rate base relevant to the Asset Exchange to an amount equivalent to (x) the number of Bolingbrook water customers acquired by CUCI, multiplied by (y) CUCI's current water rate base per customer.
 - CUCI is willing to cap any increase in its water rate base relevant to the Asset Exchange to an amount equivalent to (x) the reduction in CUCI's sewage rate base by reason of the conveyance of its sewage treatment assets to Bolingbrook, plus (y) the aggregate amount of all payments made by CUCI to Bolingbrook in relation to the Asset Exchange.

Section 5.3 of the Asset Exchange Agreement uses the Bolingbrook formulation. The Commission finds, after considering all the parol evidence submitted on the issue by both Bolingbrook and by IAWC, that the intent of the parties, as documented in Mr. Callahan's letter, was that Citizens "current water rate base per customer" was to be used in Section 5.3's formula.

In the Commission's opinion, utility plant additions, made after the Asset Exchange Agreement had been approved, are clearly includable in IAWC's rate base. The language of the last paragraph of Section 5.3 states that facilities constructed "in the future" to serve Bolingbrook Customers would be includable in rate base. However, utility plant additions made after the Agreement was approved, are not also includable in the first paragraph, which contains the formula for determining the value of Bolingbrook's water utility assets for rate base purposes.

In conclusion, the Commission finds that Bolingbrook's calculation of the rate base increment attributable to the Bolingbrook water utility plant is consistent with the terms of Section 5.3. of the Agreement and it should be accepted.

Bolingbrook Exception 2.0 to the Proposed Order (Proposed Language for Section V.G.)

G. Citizens Acquisition Savings

Staff witness Everson and Company witness Stafford provided testimony regarding IAWC's Savings Sharing Plan ("Plan") ordered in Dockets Nos. 00-0476 and 01-0556 (Staff Ex. 2-0 at 11-12; IAWC Ex. 4.0 at 23-28)

By way of **background** it is noted that the transactions by which IAWC acquired the properties of Citizens Utilities Company of Illinois ("CUCI" or "Citizens") were the subject of Docket 00-0476. The Company says that in Docket 00-0476, the Commission ordered, in rate proceedings filed within three years after the order, that savings resulting from the acquisition be shared between IAWC's shareholders and customers on a 50-50 basis.

In Docket 01-0556, the Commission entered an order approving a methodology for acquisition savings, ~~with the savings to be quantified in~~ but deferred its final approval of any purported savings until the next rate proceeding. A two-part methodology was approved, whereby one component covered savings related to cost of capital and the other covered savings not related to cost of capital.

In the instant case, IAWC Exhibit 12.0, Schedule C-2.4 contains IAWC's calculation of Acquisition Savings/Sharing by district. The schedule identifies five categories of costs: (1) labor and labor-related; (2) management fees; (3) rate case expense; (4) non-Citizens rate area long-term debt; and (5) Citizens rate area long-term debt. IAWC's witness, Ronald Stafford, describes IAWC's calculation methodology in his direct testimony, IAWC Exhibit 4.0, pages 24-28.

Staff reviewed the Company's calculation of savings/sharing. Ms. Everson said the Plan increases the revenue requirement to reflect 50% of calculated savings derived from the merger of IAWC and CUCI. Ms. Everson stated that the Company's filing determines amounts labeled as savings that increase revenue requirement for various savings categories as ordered by the Commission in Docket Nos. 00-0476 and 01-0556, the merger of IAWC and CUCI.

Ms. Everson observed that "savings" are not recorded in the financial records of any corporation, and there are not accounts the Company can provide to substantiate the amounts labeled as savings. She said these amounts are not readily provable in the traditional sense, as they do not exist as separate numbers within revenue requirement categories. According to the witness, in the traditional rate making model, savings would exist in the revenue requirement in the form of a reduced level of expense; however, in her opinion, the Commission has ordered that calculated amounts be labeled as savings with 50% to be included in the calculation of revenue requirement in this docket as an addition to operating expenses.

Ms. Everson also explained that the methodology for calculating amounts labeled as savings according to Dockets 00-0476 and 01-0556 established that expenses recorded by CUCI during 1998

would serve as the base year. The base year of 1998 was chosen to be the starting point because the merger between IAWC and CUCI had not been announced and, therefore, the levels of expense were considered to be unaffected by the announcement of the merger between IAWC and CUCI.

Amounts from 1998 were then to be restated in test-year dollars (2003 in this rate case) for purposes of the calculation. Fifty percent of the calculated amounts labeled as savings are then added to the revenue requirement to achieve the sharing. Ms. Everson said the sharing is evident in the effect on the revenue requirement: amounts labeled as savings are added to operating expense and rate base components of the revenue requirement.

With regard to "Non-Cost of Capital Savings Sharing", Staff witness Everson proposed an adjustment to Illinois-American's methodology for calculating rate case savings from the former Citizens Utilities Company of Illinois due to a difference in the starting amount; the method of escalation to test year levels; and the number of months the expense was recorded. (brief at 34-35) For purposes of this proceeding, the Company did not contest that adjustment.

With regard to "Cost of Capital Savings Sharing", the acquisition-related cost of capital savings ("Savings") for the former Citizens' service territory was determined using the methodology approved in Docket No. 01-0556. (Staff brief at 35-36) The Savings on the Assumed Debt was multiplied by the amount of assumed debt to calculate the total Savings in dollars. Next the total Savings was multiplied by 50% to determine the Savings to be included in the revenue requirement for the former Citizens' service territory. Savings to be shared with IAWC for the former Citizens' service territory equals \$158,464 and is presented in Staff Exhibit 16.0, Schedule 16.05. Staff states that if the Commission approves a higher cost for the assumed debt than the 1.25% that Staff recommends, the Savings to be shared with IAWC for the former Citizens' service territory will decline.

The Savings for the non-Citizens' service territories was also determined based on the methodology approved in Docket No. 01-0556. (Staff brief at 36) Ms. Kight calculated the embedded cost of debt excluding the Assumed Debt and the embedded cost of debt including the Assumed Debt. The embedded costs of debt are shown in Staff Exhibit 16.0, Schedules 16.04 and 16.06. Ms. Kight then multiplied the dollar balance of long-term debt in the capital structure by the difference between the Cost of Debt including Assumed Debt and the Cost of Debt Excluding Assumed Debt. The Savings to be shared with IAWC for the non-Citizens' service territories was calculated to be \$469,524 and is presented in Staff Exhibit 16.0, Schedule 16.06. Staff states that if the Commission approves a higher interest rate than the Staff recommended for either variable rate debt issue, the Savings for the non-Citizens' service territories must be recalculated or it will be overstated. As discussed later in this order, the Commission approves a higher interest rate than proposed by Staff for one of the variable rate debt issues. Therefore, consistent with Staff's recommendation, the Commission concludes that the appropriate cost of capital savings sharing applicable to the non-Citizens' service territory is \$468,004, which is reflected in the Appendix attached hereto.

Staff witness Everson “presented the adjustment of Staff’s Cost of Capital witness, Ms. Kight, for Cost of Capital Savings Sharing”. (Staff brief at 36-37; citing Staff Ex. 16.0, Schedules 16.05 and 16.06) The total Company amount provided by Staff witness Kight was allocated to the rate areas in this proceeding according to the allocation method provided by IAWC on IAWC Exhibit 12.0, Schedule C-2.4, Adjustment of Savings/Sharing. IAWC indicated in the rebuttal testimony of Ronald D. Stafford, that it did not contest this adjustment. (IAWC Ex. R-4.0 at 1)

In its brief, the Village of **Bolingbrook** disputes the manner in which “labor and labor-related savings” were calculated by IAWC in this docket. (VOB brief at 11-17) Bolingbrook argues that there is a flaw in the labor cost portion of the calculation and its inputs if a labor cost increase since IAWC assumed control can be somehow characterized as labor cost savings. Bolingbrook further argues that “IAWC has failed to meet that burden [of proof] in this case with respect to the labor cost component of the Acquisition Savings calculation.” (VOB brief at 17) Bolingbrook points to IAWC Exhibit 12.0, Schedule C-2, pp. 7 and 8 in support of its argument that between the time IAWC acquired CUCI’s assets in January, 2002, and the pro forma 2003 test year, labor and labor-related expenses have increased by \$944,000.

As noted by IAWC, neither Bolingbrook nor any other party offered separate testimony taking issue with the Company’s calculation of “labor and labor-related savings” in the Company’s proposed adjustment for acquisition savings/sharing.

In its reply brief, IAWC contends that the position appearing in Bolingbrook’s brief is untimely and unsupported by any evidence. IAWC states that Mr. Stafford explained in detail the methodology used to calculate savings in pages 23-28 of his direct testimony, that IAWC Exhibit 12.0, Schedule C-2.4 provides a summary of the Company’s calculated savings directly related to the acquisition of the properties of Citizens Utilities Company of Illinois, and that the calculations were supported by workpapers. (IAWC reply brief at 24-25)

The Company claims that Bolingbrook’s brief incorrectly references 2001 data as a starting point for measuring changes in labor costs; whereas, in Docket No. 01-0556, calendar year 1998 was approved as the correct starting point for measurement of labor and labor-related savings. (IAWC reply brief at 24-25)

IAWC also says Bolingbrook had ample opportunity to present separate testimony in opposing to labor and labor-related savings or any other acquisition savings, but elected not to do so in the instant proceeding or any other proceeding, including the proceeding approving the acquisition in Docket No. 00-0476 and the proceeding approving the Savings Sharing Methodology in Docket No. 02-0556.

Bolingbrook replies to this argument by claiming that it was under no obligation to present separate evidence because it relies on evidence submitted by IAWC, which is already part of the record in this proceeding. Bolingbrook claims that, when the record is considered in its entirety,

IAWC has failed to meet its burden of proof that labor and labor-related savings have, in fact, resulted from IAWC's acquisition of CUCI's assets.

~~Having reviewed the record, the Commission concludes that the adjustment to "labor and labor-related savings" proposed for the first time in Bolingbrook's brief should not be adopted. Staff reviewed the Company's calculation of acquisition savings/sharing and proposed adjustments where deemed appropriate. Neither Staff witnesses nor any other witnesses proposed the adjustment advanced in Bolingbrook's brief.~~

~~The Commission also agrees with the Company's contention that according to the order in Docket 00-0476, the correct starting point for measuring changes in labor costs is calendar year 1998, rather than 2001. In conclusion, the Commission finds that the adjustment proposed by Bolingbrook is not supported by evidence of record, and it should not be approved.~~

The Commission agrees with the Company's contention that, pursuant to the methodology authorized in Docket No. 00-0476, the correct starting point for measuring labor and labor-related savings is calendar year 1998. By following the methodology, the Company has established a *prima facie* case with respect to the existence of labor and labor-related savings. However, the Commission cannot ignore other facts contained in the Company's own testimony and exhibits, which also constitute part of the record in this proceeding. Exhibit 12.0, Schedule C-2, pp. 7 and 8 shows that after IAWC assumed control of CUCI's assets in January, 2002, labor and labor-related costs through the pro forma 2003 test year, have escalated by \$944,000. The evidence that labor and labor-related costs have actually increased since the Company assumed control of CUCI's assets serves to rebut the Company's *prima facie* case based on the methodology. It is the Commission's obligation to review all of the pertinent facts in the record before rendering a decision with regard to Acquisition Savings.

Having reviewed the entire record with respect to this issue, the Commission concludes that the Company has made a *prima facie* case, with respect to the existence of labor and labor-related savings relative to the CUCI asset acquisition. However, the Company's *prima facie* case has been rebutted by other evidence in the record. Specifically, Exhibit 12.0, Schedule C-2, pp. 7 and 8 shows that no labor or labor-related savings have, in fact, occurred since the Company acquired CUCI's assets. In conclusion, the Commission finds that IAWC has failed to prove by a preponderance of the evidence that the Acquisition Savings with respect to the CUCI asset acquisition have, in fact, occurred and that the adjustment proposed by Bolingbrook is supported by the evidence of record and is approved.

Bolingbrook Exception 3.0 to the Proposed Order (Proposed Language for the Third Paragraph, Page 116, Section VII.H.2. of the Proposed Order)

In reviewing the record, it appears that if rates are set to achieve the approved revenue requirement for the Chicago Metro sewer rate area, such rates would ~~not produce revenues that exceed the Company's original revenue requirement proposal~~ filed tariff rates, and would not produce a revenue increase in excess of that requested in the Company's original filing. In the Commission's opinion, ~~while the burden should not be on Staff to update its rate proposal, the Company should be allowed to file rates that achieve the approved revenue requirement for the Chicago Metro sewer rate area~~ allowing the Company to charge rates in excess of the filed tariff rates would violate 220 ILCS 5/9-201(a) and should not be approved. The Commission, therefore, approves the Staff's adjustment.

Bolingbrook Exception 4.0 to the Proposed Order (Proposed Language Beginning with the last full paragraph on page 114 and ending with the last full paragraph on page 115, Section VII.H.2 of the Proposed Order)

The Commission turns next to the AG's proposal for movement toward standardizing rates across all IAWC rate areas. The Commission has previously found that, in certain circumstances, standardization of rates and the implementation of the single tariff pricing or "STP" group is appropriate. Currently, the Southern, Peoria, Streator and Pontiac districts are combined for revenue requirement purposes, and to some extent have uniform rates, in the SPSP district.

~~With regard to the particular STP proposal advanced by the AG, the Commission first observes that this proposal is an integral part of the AG's overall cost allocation and rate structure approach, and is linked to and dependent on the other elements of that approach. As such, the AG's proposal is somewhat of an "all or nothing approach". As noted above, the AG's analysis is well explained in its testimony and briefs; however, the Commission believes, as explained above, that of the alternatives in the record, Staff's cost of service methodology is the one that is most appropriate for allocating costs and designing rates in this proceeding. Thus, use of the AG's rate standardization proposal on its own would be problematic.~~

~~One factor the Commission believes must be considered before implementing standardized rates or incorporating a rate area into a single pricing group is whether the resulting rates bear a reasonable relationship to cost of service. For example, as Staff has stated, different types of sources of supply can result in significantly different costs. In this docket, the Commission finds that there is inadequate information to evaluate the relationship between the AG's proposed rates both with respect to cost of service by rate area or allocated cost responsibility by customer class.~~

~~Another important concern in moving toward STP is consideration and mitigation of rate impacts, and it has been the Commission's practice to move gradually toward single tariff pricing where appropriate. Despite the potential benefits, imposing STP can result in very large increases for some types of customers in some districts. This problem is exacerbated when large numbers of rate districts are coupled with large rate increase requests, such as in the instant case. Under such circumstances, any significant progress in the movement toward STP is difficult.~~

~~For the reasons stated by the AG, however, the Commission does believe that further movement toward STP in the future should be considered. In furtherance of this practice, the Commission has directed IAWC to provide billing information for the Pontiac district usage based upon the then current Pontiac usage block structure as well as the STP usage block structure. This type of information will assist the Commission in evaluating the propriety of moving the Pontiac district more fully into the STP group.~~

As noted above, the AG requested in its brief that IAWC be directed to produce a cost of service study, based on the base extra capacity method, for its next rate case. While IAWC is free

to produce one or more cost of service studies for its next rate case, the Commission finds imposing such a requirement is unnecessary at this time. Given that Staff routinely provides cost of service studies for water rate cases, and that any other party to a proceeding is also free to do so, the Commission will not require the Company to provide a cost of service study over its objections at this time. As indicated above, the Company has been directed to provide updated demand data in its next filing, which the Commission believes will be of benefit to others in preparing or reviewing COS analyses.

After due consideration of all the alternative rate design proposals in the record, the Commission finds that use of the AG's STP proposal is the most appropriate for allocating costs and designing rates in this proceeding. The benefits of AG's STP proposal outweigh any potential disadvantages. The Company is an integrated water and wastewater service provider in Illinois and its rate structure should reflect that integration by means of single tariff pricing, as per Appendix A hereof.